STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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October 14, 2011

Dear Interested Party:

Enclosed is the Initial Discussion Paper on Regulation 1684, *Collection of Use Tax by Retailers*. Discussion regarding proposed amendments to Regulation 1684 is scheduled for the Board's **February 28-29, 2012 Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, meetings are scheduled at the following Board of Equalization offices:

Sacramento: October 31, 2011 at 10:00 a.m.
450 N Street, Room 122
Sacramento, California

Culver City: November 2, 2011 at 10:00 a.m.
5901 Green Valley Circle, Room 207
Culver City, California.

If you are unable to attend a meeting but would like to provide input for discussion, please feel free to write to me at the above address or send a fax to (916) 322-4530 before October 27, 2011. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend any of the meetings, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Mr. Robert Wilke at (916) 445-2137 or by e-mail at Robert.Wilke@boe.ca.gov prior to October 27, 2011. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of the meeting room and to arrange for teleconferencing.

Whether or not you are able to attend the above interested parties' meetings, please keep in mind that the due date for interested parties to provide written responses to staff's analysis is **November 18, 2011**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Hellmuth, Supervisor, Business Taxes Committee Team, at (916) 322-5271.

Sincerely,

Susanne Buehler

Susanne Buehler, Chief
Tax Policy Division
Sales and Use Tax Department

SB: rsw

Enclosures

cc: (all with enclosures)
Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, Member, First District (MIC 71)
Senator George Runner (Ret.), Member, Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel

(Via E-mail)
Mr. Robert Thomas, Board Member's Office, Fourth District
Mr. Neil Shah, Board Member's Office, Third District
Mr. Tim Treichelt, Board Member's Office, Third District
Mr. Alan LoFaso, Board Member's Office, First District
Ms. Mengjun He, Board Member's Office, First District
Mr. James Kuhl, Board Member's Office, Second District
Mr. Lee Williams, Board Member's Office, Second District
Ms. Natasha Ralston Ratcliff, State Controller's Office
Ms. Kristine Cazadd
Mr. Randy Ferris
Mr. Jeffrey L. McGuire
Mr. Jeff Vest
Mr. David Levine
Mr. Bradley Heller
Mr. Robert Tucker
Ms. Christine Bisauta
Mr. Todd Gilman
Ms. Laureen Simpson
Mr. Robert Ingenito Jr.
Mr. Bill Benson
Mr. Stephen Rudd
Mr. Kevin Hanks
Mr. Geoffrey E. Lyle
Ms. Leila Hellmuth
Mr. Robert Wilke

INITIAL DISCUSSION PAPER

Sales and Use Tax Regulation 1684, *Collection of Use Tax by Retailers*

Issue

Whether the Board should amend Sales and Use Tax Regulation (Regulation) 1684, *Collection of Use Tax by Retailers*, to implement, interpret, and make specific the amendments made to Revenue and Taxation Code section 6203 (section 6203) by section 3 of Assembly Bill No. 155 (AB 155) (Stats. 2011, ch. 313), which will change the definition of "retailer engaged in business in this state" operative September 15, 2012, or January 1, 2013.

Background

Current Regulation 1684 and Current Section 6203

Regulation 1684 requires "[r]etailers engaged in business in this state as defined in Section 6203" to register with the Board, collect California use tax from their California customers, and remit the use tax to the Board. The regulation also provides that such retailers are liable for California use taxes that they fail to collect from their customers and remit to the Board.

Current Provisions of Section 6203
Currently, the operative provisions of section 6203, subdivision (c)(1) through (3), define the term "retailer engaged in business in this state" by providing that:

> "Retailer engaged in business in this state" as used in this section and Section 6202 means and includes any of the following:
>
> (1) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business.
>
> (2) Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.
>
> (3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in this state. (Current section 6203, subd. (c)(1)-(3).)

The current operative provisions of section 6203, subdivision (d)(1), address the taking of orders over the Internet by providing that:

> For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision

> shall apply only to a computer telecommunications network that consists substantially of online communications services other than the displaying and taking of orders for products.

In addition, the current operative provisions of section 6203, subdivision (e) provide that a retailer is not a "retailer engaged in business in this state" if that retailer's "sole physical presence in this state" is to engage in limited convention and trade show activities, as specified.

Current Provisions of Regulation 1684

Currently, Regulation 1684 does not define the full scope of the phrase "engaged in business in this state as defined in Section 6203." Instead, Regulation 1684, subdivision (a), provides, in relevant part, the following guidance regarding the meaning of "engaged in business in this state" as currently defined by section 6203, subdivisions (c) and (d):

> Any retailer deriving rentals from a lease of tangible personal property situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.
>
> The use of a computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.
>
> A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

Regulation 1684, subdivision (b), also incorporates the current provisions of section 6203, subdivision (e) regarding convention and tradeshow activities.

<u>Section 6203 as Amended by AB 155</u>

Section 6203, subdivision (c), as amended by AB 155, will define the term "retailer engaged in business in this state" more broadly then current section 6203, subdivision (c), and provide that the term means "any retailer that has substantial nexus with this state for purposes of the commerce clause of the United States Constitution and any retailer upon whom federal law permits this state to impose a use tax collection duty."

Section 6203, subdivision (c)(1) through (3), as amended by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to, retailers engaged in the activities described in current section 6203, subdivision (c)(1) through (3) (quoted above). Subdivision (c)(4), as added to section 6203 by AB 155, will further provide that "retailer engaged in business in this state" specifically includes, but is not limited to, any retailer that is a member of a "commonly controlled group" as defined in section 25105 of the Revenue and Taxation Code, and is a member of a "combined reporting group," as defined by the Franchise Tax Board (FTB) in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), "that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer . . . ."

In addition, subdivision (c)(5)(A), as added to section 6203 by AB 155, will provide that the term "retailer engaged in business in this state" specifically includes, but is not limited to "[a]ny retailer entering into an agreement or agreements under which a person or persons [e.g., an affiliate or affiliates] in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise," but only if: (1) "The total cumulative sales price from all of the retailer's sales, within the preceding 12 months, of tangible personal property to purchasers in this state that are referred pursuant to all of those agreements with a person or persons in this state, is in excess of ten thousand dollars ($10,000)"; and (2) "The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in this state in excess of one million dollars ($1,000,000)."

However, subdivision (c)(5)(B), as added to section 6203 by AB 155, will provide that: "An agreement under which a retailer purchases advertisements from a person or persons in this state, to be delivered on television, radio, in print, on the Internet, or by any other medium, is not an agreement described in subparagraph (A), unless the advertisement revenue paid to the person or persons in this state consists of commissions or other consideration that is based upon sales of tangible personal property." Subdivision (c)(5)(C), as added to section 6203 by AB 155, will provide that: "Notwithstanding subparagraph (B), an agreement under which a retailer engages a person in this state to place an advertisement on an Internet Web site operated by that person, or operated by another person in this state, is not an agreement described in subparagraph (A), unless the person entering the agreement with the retailer also directly or indirectly solicits potential customers in this state through use of flyers, newsletters, telephone calls, electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state." Subdivision (c)(5)(D), as added to section 6203 by AB 155, will provide that for purposes of paragraph (c)(5), "retailer" includes "an entity affiliated with a retailer within the meaning of Section 1504 of the Internal Revenue Code." Also, subdivision (c)(5)(E), as added to section 6203 by AB 155, will provide that paragraph (c)(5) "shall not apply if the retailer can demonstrate that the person in this state with whom the retailer has an agreement did not engage in referrals in the state on behalf of the retailer that would satisfy the requirements of the commerce clause of the United States Constitution."

Finally, it should be noted that the amendments made to section 6203 by AB 155 will also delete the provisions in current section 6203, subdivision (d), regarding the "taking of orders from customers in this state through a computer telecommunications network," and renumber current section 6203, subdivision (e)'s provisions regarding convention and tradeshow activities as section 6203, subdivision (d).

Discussion

Physical Presence Test

Article I, section 8, clause 3 of the United States Constitution expressly authorizes the United States Congress to "regulate Commerce with foreign Nations, and among the several States" (Commerce Clause). In *Quill Corporation v. North Dakota* (1992) 504 U.S. 298, the United States Supreme Court explained that:

- The Commerce Clause grants Congress affirmative legislative authority and, by its own force, prohibits certain state actions that interfere with interstate commerce (*Id.* at p. 309);
- Subject to Congress's legislative authority, the Commerce Clause prohibits a state from requiring a retailer engaged in interstate commerce to collect the state's use tax unless the retailer has a "substantial nexus" with the state (see *id*. at p. 311);
- In the absence of congressional action, the bright line rule, established in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* (1967) 386 U.S. 753, that a retailer must have a "physical presence" in a taxing state in order for that state to impose a use tax collection obligation on the retailer is still applicable today (see *id*. at pp. 317-318); and
- *National Bellas Hess* interpreted the Commerce Clause as establishing a "safe harbor" prohibiting a state from requiring a retailer to collect that state's use tax if the retailer's only connection with customers in the state is by common carrier or the United States mail, which, in the absence of congressional action, is still applicable today (see *id*. at p. 315).

Historically, the United States Supreme Court has agreed that the safe harbor established in *National Bellas Hess* (and reaffirmed in *Quill*) is limited and does not apply when a retailer's "connection with the taxing state is not exclusively by means of the instruments of interstate commerce." (*National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 556 [quoting from and affirming the California Supreme Court's decision in *National Geographic Society v. State Board of Equalization* (1976) 16 Cal.3d 637, 644].) The United States Supreme Court has specifically found that the safe harbor does not apply to an out-of-state retailer that has established a place of business in the taxing state, even if the retailer's in-state business activities are unrelated to the retailer's sales of tangible personal property to customers in that state. (*Id*. at p. 560.) The United States Supreme Court has specifically explained that the safe harbor does not apply if a retailer attempts to negate its connections with a taxing state by

organizing itself or its activities in such a way as to "departmentalize" its connection with the taxing state so that the connection is isolated from the retailer's obvious selling activities. (*Id*. at pp. 560-561.) This is so regardless of whether the connection involves an in-state person who may be characterized as an employee, agent, representative, salesperson, solicitor, broker, or independent contractor, and regardless of whether the activities creating the connection are directly related to the retailer's sales of tangible personal property to customers in the state. (*Ibid*.; see also *Scripto, Inc. v. Carson Sheriff* (1960) 362 U.S. 207, 211-212.) The United States Supreme Court has also specifically found that the safe harbor does not apply if a retailer has "property within [the taxing] State." (*National Geographic Society*, *supra*, 430 U.S. at p. 559 [quoting *National Bellas Hess*].)

Further, the California Supreme Court previously held that "the slightest [physical] presence" in California would be sufficient to create a substantial nexus between a retailer and this state. (*National Geographic Society*, *supra*, 16 Cal.3d at p. 644.) However, the United States Supreme Court did not agree with the California Supreme Court's slightest presence standard on appeal (*National Geographic Society*, *supra*, 430 U.S. at p. 556). Further, the United States Supreme Court subsequently held that a retailer did not have a substantial nexus with a taxing state solely because the retailer licensed a few customers to use software on a few floppy disks located within the taxing state. (*Quill*, *supra*, 504 U.S. at p. 315, fn. 8.)

More recently, the Court of Appeals of New York (i.e., New York's highest appellate court) explained that, while the "physical presence" test affirmed in *Quill* requires that a retailer have more than the slightest physical presence in a state before that state can require the retailer to collect the state's use tax, the physical presence "does not need to be substantial" and "it may be manifested by the presence in the taxing State of the [retailer's] property or the conduct of economic activities in the taxing State performed by the [retailer's] personnel or on its behalf." (*Orvis Co., Inc., v. Tax Appeals Tribunal of the State of New York et al.* (1995) 86 N.Y.2d 165, 178.) Furthermore, the California Court of Appeal expressly agreed with and followed the Court of Appeals of New York's construction of the physical presence test in *Borders Online, LLC. v. State Board of Equalization* (2005) 129 Cal.App.4th 1179, 1198-1199. And, the California Court of Appeal further explained that activities performed in California by or on behalf of a retailer will be sufficient to satisfy the physical presence test if they enhance the retailer's sales to California customers and significantly contribute to the retailer's ability to establish and maintain a market in California. (*Id*. at p. 1196.)

<u>Commonly Controlled Group Nexus</u>

Board staff is aware that, in *Current, Inc. v. State Board of Equalization* (1994) 24 Cal.App.4th 382, the California Court of Appeal concluded that an out-of-state corporate retailer with no stores, solicitors, or property within California does not have a physical presence in California solely because it is acquired by another corporation that is a retailer with a physical presence. However, in that case, the California retailer's activities did not give the out-of-state retailer a physical presence in California because:

- Neither entity was the alter ego or agent of the other for any purpose;

- Neither entity solicited orders for the products of the other, and neither accepted returns of the merchandise of the other or otherwise assisted or provided services for customers of the other;
- Each entity owned, operated, and maintained its own business assets, conducted its own business transactions, hired and paid its own employees, and maintained its own accounts and records;
- Neither entity held itself out to customers or potential customers as being the same as, or an affiliate of, the other;
- Each entity had its own trade name, goodwill, marketing practices and customer lists and marketed its products independently of the other; and
- Neither purchased goods or services from the other. (*Id*. at p. 388.)

Board staff does not believe that the holding in *Current* affects the validity of the provisions of section 6203, subdivision (c)(4), that will become operative on September 15, 2012, or January 1, 2013, which provide that a retailer is engaged in business in California if: (1) the retailer is a member of a commonly controlled group, as defined in section 25105 of the Revenue and Taxation Code; and (2) the retailer is a member of a combined reporting group, as defined in Franchise Tax Board Regulation 25106.5, subdivision (b)(3), that includes "another member of the retailer's commonly controlled group that, ***pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer***, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer." (Emphasis added.)

This is because the United States Supreme Court agreed with the Washington Supreme Court, in *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue* (1987) 482 U.S. 232, 250-251, that a retailer has a substantial nexus with a taxing state if there are persons in that state performing activities on behalf of the retailer that enable the retailer to "establish and maintain a market." In 2005, the California Court of Appeal subsequently quoted *Tyler Pipe* before concluding that an out-of-state retailer organized as a limited liability company (LLC) had a substantial nexus with California because a separate corporation, affiliated with the LLC through a common parent, performed activities in California on behalf of the retailer that were significantly associated with the retailer's ability to establish and maintain its California market. (*Borders Online, supra*, 129 Cal.App.4th at pp. 1196, 1197.) Accordingly, Board staff believes that the California Court of Appeal's holding in *Current* would have been different if the in-state corporation had performed services in California in connection with tangible personal property to be sold by the out-of-state corporation, pursuant to an agreement with or in cooperation with the out-of-state corporation (i.e., if the provisions of section 6203, subdivision (c)(4) (emphasized above) had been operative and satisfied in that case).

Affiliate Nexus

The State of New York has enacted an affiliate nexus statute that is similar to the provisions of section 6203, subdivision (c)(5), as amended by AB 155. The New York statute creates a rebuttable presumption that a retailer is soliciting business in New York through an independent contractor or other representative and is required to register to collect New York use tax if the retailer enters into an agreement with a resident of New York under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, if the retailer's cumulative gross receipts from sales to customers in New York who were referred to the retailer by residents with the requisite agreements is in excess of $10,000 during the four proceeding quarters. (N.Y. Tax Law § 1101, subd. (b)(8)(vi).) The New York statute also provides that the presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer "that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question." (*Ibid*.)

Amazon.com LLC filed a lawsuit in New York seeking declaratory and injunctive relief on the ground that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; however, when the Supreme Court of New York County (i.e., a New York trial court) denied the relief, Amazon.com LLC dropped its facial challenge and appealed the trial court's decision on other grounds, including the ground that the New York statute allegedly violates the Commerce Clause as applied to Amazon.com LLC. (*Amazon.com, LLC, et al. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.) Overstock.com, Inc. also filed a lawsuit in New York seeking injunctive and declaratory relief on the ground that that the New York statute is unconstitutional on its face because, among other things, it allegedly violates the Commerce Clause; and when the Supreme Court of New York County denied the relief, Overstock.com, Inc. argued that the statute allegedly violates the Commerce Clause both on its face and as applied to Overstock, Inc. when it appealed the Supreme Court of New York County's decision. (*Overstock.com, Inc. v. New York State Department of Taxation and Finance* 2010 N.Y. Slip Opn. 7823.)

Amazon.com, LLC's and Overstock.com, Inc.'s appeals were consolidated into one matter before the Appellate Division of the Court of Appeals of New York (i.e., an intermediate appellate court) and jointly decided on November 4, 2010. (2010 N.Y. Slip Opn. 7823.) In that decision, the Appellate Division concluded that the New York statute is consistent with the "physical presence" test, which was affirmed in *Quill* and discussed at length in *Orvis*, because it only requires a retailer to register to collect New York use tax if the retailer enters into a business-referral agreement with a New York resident, the resident actively solicits business in New York, as opposed to merely posting a passive advertisement, and the resident receives a commission based upon the sales successfully solicited in New York. (2010 N.Y. Slip Opn. 7823, at pp. 8-10.)

Board staff believes that, after remand back to the trial court for further factual development, both Amazon.com, LLC and Overstock.com, Inc. may continue to press their objections to the Appellate Division's decision to the Court of Appeals of New York (i.e., New York's highest

appellate court). However, in the meantime, the New York State Department of Taxation and Finance has issued Technical Services Bureau Memorandum TSB-M-08(3)S (May 8, 2008), which explains the rebuttable presumption in the New York statute and provides that the "Tax Department will deem the presumption rebutted where the [retailer] is able to establish that the only activity of its resident representatives in New York State on behalf of the [retailer] is a link provided on the representatives' Web sites to the [retailer's] Web site and none of the resident representatives engage in any solicitation activity in the state targeted at potential New York State customers on behalf of the [retailer]." And, TSB-M-08(3)S further provides that "an agreement to place an advertisement does not give rise to the presumption"; however, "placing an advertisement does not include the placement of a link on a Web site that, directly or indirectly, links to the Web site of a [retailer], where the *consideration for placing the link on the Web site is based on the volume of completed sales generated by the link.*" (Emphasis added.)

The New York State Department of Taxation and Finance also issued Technical Services Bureau Memoranda TSB-M-08(3.1)S (June 30, 2008), which provides that a retailer may rebut the presumption that it has nexus under the New York statute by meeting both of the following conditions:

1. Contract condition – Showing that the contract or agreement between the retailer and the resident representative provides that the resident representative is prohibited from engaging in any solicitation activities in New York that refer potential customers to the retailer, including, but not limited to, distributing flyers, coupons, newsletters and other printed promotional materials, or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails, and, if the resident representative is an organization (such as a club or a nonprofit group), showing that the contract or agreement also provides that the organization will maintain on its Web site information alerting its members to the prohibition against each of the solicitation activities described above; and
2. Proof of compliance condition – Showing that each resident representative has submitted to the retailer, on an annual basis, a signed certification stating that the resident representative has not engaged in any prohibited solicitation activities in New York, as described above, at any time during the previous year, and, if the resident representative is an organization, that the annual certification also include a statement from the resident organization certifying that its Web site includes information directed at its members alerting them to the prohibition against each of the solicitation activities described above.

However, as to the proof of compliance condition, a signed certification from a resident representative may only be used to rebut the presumption in the New York statute if the retailer accepts it in good faith (i.e., the retailer does not know or have reason to know that the certificate is false or fraudulent).

In addition, Board staff is aware that subdivision (a)(1) of Regulation 1540, *Advertising Agencies and Commercial Artists*, provides that: "Advertising is commercial communication utilizing one or more forms of communication (such as television, print, billboards, or the Internet) from or on

behalf of an identified person to an intended target audience." Board staff is also aware that, in the administrative appeal of Barnes & Noble.com, LLC, the Board had to determine whether certain in-state activity constituted "advertising" or "selling." In the Memorandum Opinion the Board adopted to decide the Barnes & Noble.com appeal, the Board stated that "an 'advertisement' is a 'written, verbal, pictorial, graphic, etc., announcement of goods or services for sale, employing purchased space or time in print or electronic media.'" However, the Board also concluded that when California employees of Barnes & Noble Booksellers, Inc. (B&N Booksellers), physically distributed coupons to B&N Booksellers' customers, which could only be used to make discounted purchases from Barnes & Noble.com (B&N.com), the acts of physically distributing the coupons directly to the potential customers of B&N.com were solicitations of those persons, and went beyond mere advertising to the public at large. (Memorandum Opinion, *Barnes & Noble.com*, adopted September 12, 2002.)

Furthermore, Board staff has found that Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) provides that the word "advertise" means "[t]o make known to the public through a medium of publicity that one's goods or services are available for sale or engagement." In addition, Ballentine's Law Dictionary (3d ed. 2010 LexisNexis) defines the word "solicit" as "to invite a business transaction" or "[t]o importune, entreat, implore, ask, attempt, or try to obtain an order" and defines the phrase "solicitation of business" as "seeking orders for goods or services."

Websites

Enactment of Current Section 6203, Subdivision (d)
Statutes 1994, chapter 851 (Assem. Bill No. 72, Klehs (AB 72)), section 2 added a new subdivision (k) to section 6203 to provide as follows:

> (k) (1) For purposes of this section, "engaged in business in this state" does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of on-line communications services other than the displaying and taking of orders for products.
>
> (2) This subdivision shall become inoperative upon the earlier of the following dates:
>
> (A) The operative date of either (i) provisions of S. 1825 of the 103rd Congress of the United States that authorize states to compel the collection of state sales and use taxes by out-of-state retailers or (ii) substantially similar provisions of another Congressional act.
>
> (B) The date five years from the effective date of the act adding this subdivision.

The legislative digest included in the August 30, 1994, Assembly Floor Analysis of AB 72, provides that "Existing law . . . [m]akes a determination regarding whether or not a retailer is doing business in the state (has 'nexus' in the state) based on a number of factors including: physical location in the state; use of agents in the state; or ownership of a related in-state business." The legislative digest further provides that the provisions of subdivision (k)(1) (above) "[e]xclude from the definition of a retailer 'engaged in business in this state' any electronic display of products or receipt of orders on a computer network located in California, if the network is not owned by the retailer" and "specify that the computer network exception applies only to networks that consist substantially of on-line services other than the display and taking of orders for products." The comments section of the August 30, 1994, analysis of AB 72 also explains that:

> Apple Computer is currently developing an on-line home computer network, e.World. The network would like to offer subscribers the ability to shop on-line from Lands End and other direct marketing operations. Apple currently intends to locate the mainframe computer which supports the e.World network in Napa. Subscribers to the network would be connected to the mainframe through modems and phone lines.
>
> The Board of Equalization has indicated to e.World that because of the mainframe's location in California, the board believes that any retailer advertising on the e.World network should be considered to have nexus in-state. Accordingly, the board argues that retailers advertising on the network should be required to collect sales tax both on sales made through e.World and any other sales to consumers in California.
>
> While e.World does not believe that BOE would be able to enforce this position (e.World believes the computer network functions much like a direct seller phone order system which is not subject to tax), the advi[c]e has had a chilling effect on e.World's ability to attract retailers to advertise on the network. Accordingly, absent some clarification of the law, e.World indicates it will likely be forced to relocate the mainframe system outside the state.
>
> This bill makes clear that a retailer who otherwise would not be required to collect sales tax, would not be required to do so simply because they advertise on a computer network which they do not own.

Revenue and Taxation Code section 6203, subdivision (g), was subsequently deleted and subdivision (k) was renumbered as subdivision (j) by Statutes 1995, chapter 555 (Sen. Bill No. 718), section 7 (before eventually being renumbered as current subdivision (d), which does not contain the original sunset provision).

Adoption of Regulation 1684's Current Website Provisions
The Silicon Valley Software Industry Coalition (Coalition) submitted written comments to the Board for consideration during the July 31, 1997, public hearing regarding proposed amendments to Regulation 1684 to address the use of websites. The Coalition's comments explain that:

> [T]he Governor of New York held a press conference [in early 1997] to announce that the mere presence of a company's web site in their state did not constitute nexus for tax purposes in New York. Unfortunately, New York's governor then went on to specifically state that California web-site hosting companies should leave California and relocate in New York, thus implying that California laws created an opposite result. CommerceNet and the Coalition disagreed with New York['s] interpretation of California's laws and requested the State Board of Equalization to make clear that California's law does not create an incentive for California web-hosting companies to leave California in order to protect their customers from over-reaching tax laws.

As a result of the request, the Board directed staff to prepare a memorandum regarding website nexus and Board staff subsequently submitted Formal Issue Paper 97-005 to the Board for discussion at its April 8, 1997, Business Taxes Committee (BTC) meeting. Formal Issue Paper 97-005 opined that:

> In 1993, we received a request for advice regarding a company contemplating starting an on-line computer service similar to on-line service providers. The host computers for the service would be located in California. The company's plan was to offer retailers of tangible personal property the opportunity to place their catalogs on line to be accessed by the on-line company's customers who could also place orders for such tangible personal property over the on-line service. This selling function would not be the primary function of the on-line service; rather, it would consist substantially of on-line services other than the displaying and taking of orders for products. The company asked whether retailers using the service in this manner to display their catalogs and accept orders through the on-line service would be regarded as retailers engaged in business in California by virtue of this activity.
>
> The company's plan consisted of acting as the out-of-state retailers' representative in this state through its computers located in this state that were used to display tangible personal property for sale and take orders for such property on the out-of-state retailers' behalf. Thus, the staff's conclusion was that the out-of-state retailers would be "engaged in business" in California under subdivision (b) of Revenue and Taxation Code section 6203 by using the company as their representative in this state for purposes of selling tangible personal property.
>
> The company sought relief from the application of subdivision (b) of section 6203 from the Legislature. In cases such as this, if the Legislature chooses to pass

legislation, it can do so in several ways. It can pass a statute that simply reverses the interpretation given to the taxpayer. When it does so, it sometimes does so by making the reversal "declaratory of existing law," indicating an intent that the Legislature's provision be retroactive. The Legislature may just make its reversal prospective. The Legislature may, instead of either of these methods, choose to pass a narrowly tailored provision to apply to very specific circumstances. This is what it did in response to the company's request for relief. The Legislature did not pass an outright reversal of the interpretation that a retailer is engaged in business in California if it uses a computer service which is physically located in California to advertise and take orders for sales of tangible personal property. Instead, in narrowly tailored legislation carried by then Assemblyman Johan Klehs, the Legislature adopted subdivision (j) of section 6203 in 1994. The bill was effective September 27, 1994, but became operative on January 1, 1995. (This provision was originally lettered subdivision (k), but has since been relettered (j).) This provision states:

> (1) For purposes of this section, 'engaged in business in this state' does not include the taking of orders from customers in this state through a computer telecommunications network located in this state which is not directly or indirectly owned by the retailer when the orders result from the electronic display of products on that same network. <u>The exclusion provided by this subdivision shall apply only to a computer telecommunications network that consists substantially of on-line communications services other than the displaying and taking of orders for products.</u> (Emphasis added in original.)
>
> (2) This subdivision shall become inoperative upon the earlier of the following dates:
>
> (A) The operative date of provisions of a congressional act that authorize states to compel the collection of state sales and use taxes by out-of-state retailers.
>
> (B) The date five years from the effective date of the act adding this subdivision.

This provision applies only to circumstances where the advertising and order-taking is made through a computer telecommunications network which consists substantially of on-line services *other than* the displaying and taking of orders for tangible personal property. Thus, a retailer who displays and takes orders through a computer telecommunications network located in California which does *not* consist substantially of on-line communications services other than the displaying and taking of orders for tangible personal property within the meaning of subdivision (j) of section 6203 arguably should be regarded as engaged in business in California under subdivision (b) of section 6203 (since the subdivision

> (j) exclusion would not apply). Any other interpretation of subdivision (j) would render it surplusage.
>
> The Legislature effectively stated that this type of activity comes within the definition of "engaged in business" in California of subdivision (b) by adopting a sunset date to the subdivision (j) exclusion to the otherwise applicable provisions of section 6203. Subdivision (j) becomes inoperative in 1999. If this activity did not otherwise come within subdivision (b), there would have been no reason to adopt the narrow subdivision (j) exclusion, nor would there be any reason to have its provisions sunset in 1999. Every provision in a statute must be given meaning whenever possible since the Legislature is presumed not to engage in idle acts. *(Silberg v. Anderson* (1990) 50 Ca1.3d 205, 216; *General American Transportation Corp. v. State Bd. of Equalization* (1987) 193 Cal.App.3d 1175, 1181.) Thus, the displaying and taking of orders on a computer located in California brings retailer within subdivision (b) of section 6203. The remaining question is whether the activity comes within the subdivision (j) exclusion from the otherwise applicable provisions of subdivision (b).

However, Mr. Klehs, then Vice Chair of the Board, also distributed his own written comments to the Board on April 8, 1997, for consideration at the BTC meeting that day, which construed the legislative intent underlying the enactment of then subdivision (j). Mr. Klehs' comments provide that "[t]he legislative intent of AB 72 (Klehs-1994) was to give the BOE staff clear guidance that a retailer is not 'engaged in business' in California merely because it maintains a web-site on a third party's computer which is located in this state, as long as the host computer network consists substantially of services other than displaying and taking of orders for products. In other words, products sold through web sites or over the internet should be treated for nexus purposes the same as mail order or telephone sale products."

The minutes from the Board's April 8, 1997, BTC meeting further explain that:

> The members unanimously agreed to direct staff to incorporate, for the Board's consideration to approve publication, the amendment to Regulation 1684 drafted by Dr. Connell and Mr. Andal, with legislative intent provided by Mr. Klehs in the attached memo of April 8, 1997, and support by Mr. Dronenburg for the amending language.
>
> Staff was directed to incorporate the proposed amendment to Regulation 1684 as approved by the members. A draft of those amendments is attached.

The original amendments drafted by Dr. Connell and Mr. Andal provided that: "An out-of-state retailer whose only contact with this state is the use of a computer server on the Internet to create or maintain a World Wide Web page or site does not constitute 'substantial nexus' with this state. No Internet Service Provider, On-line Service Provider or other similar provider of Internet access services or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer solely as a result of the service provider maintaining a

web page or site on a computer server that is physically located in this state." However, during the July 31, 1997, public hearing regarding the adoption of the proposed amendments, the Board directed staff to change the second sentence based upon comments from interested parties so that the second sentence provided that "No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state." The revised amendments were then adopted on September 10, 1997, and remain part of subdivision (a) of Regulation 1684 today.

The Final Statement of Reasons provides the following factual basis for the adoption of the proposed amendments:

> In recent years, two business practices have arisen which raise the issue as to whether or not the retailers practicing them thus became engaged in business in this state. First, some out-of-state retailers have established Web Sites (electronic files maintained on computers called servers) on the World Wide Web, part of the Internet, for the purpose of making sales. The Internet evolved from a Defense Department project in the late 1960's, and has grown to be a world-spanning network of at least 60,000 smaller, independent computer networks linked by satellites, coaxial cable, and phone lines. The World Wide Web is a smaller network of hyperlinked documents within the Internet. (Yahoo! Internet Life (8/97), p. 62) Servers mainly belong to service providers, either Independent Service Providers (ISP's), or national commercial on-line services like Prodigy or America On-Line. The server on which the Web Site is located may or may not be sited in California. Confusion has arisen as to whether or not an in-state ISP who hosts an out-of-state retailer's Web Site is a "representative" within the meaning of Section 6203(b) for use tax collection purposes and, if so, whether the exemption contained in Section 6203(j), whereby nexus is not provided by a retailer's use of an on-line service for the purpose of taking orders for tangible personal property if the primary purpose of the service is not the sale of tangible personal property, applies to a retailer's Web Site carried by a general-interest ISP which hosts a myriad of Web Sites as well as to a proprietary on-line service. Legislation has been introduced to clarify these principles, but none has yet been enacted. As more and more business is being conducted on the Internet, the Board concluded that it was necessary to resolve this issue by regulation to bring some certainty to this area pending legislative action. Upon consultation with industry, the Board concluded that a Web Site is a utility service operating through communications lines to forward a buyer's order to the retailer, so that orders placed through a Web Site should be treated for nexus purposes like orders placed through the mail which the United States Supreme Court has determined does not provide "nexus." (Quill Corporation v. North Dakota (1992) 504 U.S. 298.) The Board also concluded that the Legislature did intend that Section 6302(j) apply to Web Sites hosted by ISP's as well as to proprietary networks.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a) regarding the use of websites was based upon the Board's 1997 interpretation of *Quill* and not solely the express language of subdivision (k) of section 6203, as added by AB 72 (currently subdivision (d) of Revenue and Taxation Code section 6203), which will be inoperative on September 15, 2012, or January 1, 2013, due to the provisions of AB 155. However, Board staff is not aware of any published California or federal court case decided before or after 1997 that expressly addresses whether a retailer has substantial nexus with a taxing state when the retailer uses a third party's server in a taxing state or when the retailer has an Internet Service Provider performing activities on behalf of the retailer in a taxing state. If an out-of-state retailer owns a server in California (as opposed to merely purchasing web services through a third party's servers), under the current (and continuing) provisions of section 6203, subdivision (c)(1), the retailer has a place of business in California where the server is located and is, thus, obligated to collect California use tax. As set forth in more detail below, California's approach to servers is similar to the statutory approaches taken by New York and Washington.

New York's Website Statute
New York's Technical Services Bureau Memoranda TSB-M-97 (1.1)C Corporation Tax and (1.1)S Sales Tax (November 15, 1999) explain that:

> On October 8, 1998, Governor George E. Pataki signed into law new legislation to codify existing state policy with regard to taxation of Internet access, as previously announced in Technical Services Bureau Memoranda TSB-M-97(1)S and TSB-M-97(1)C, which are obsolete and are replaced by this memorandum. This new legislation added sections 12, 179, and 1115(v) to the Tax Law, and is applicable, for sales and compensating use tax purposes, to sales or uses made on or after February 1, 1997.

The provisions of New York Tax Law section 12 provide that:

> (a) For purposes of subdivision (b) of this section, the term "person" shall mean a corporation, joint stock company or association, insurance corporation, or banking corporation, as such terms are defined in section one hundred eighty-three, one hundred eighty-four, or one hundred eighty-six, or in article nine-A, thirty-two or thirty-three of this chapter, imposing tax on such entities.
>
> (b) No person shall be subject to the taxes imposed under section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six, or article nine-A, thirty-two or thirty-three of this chapter, solely by reason of (1) having its advertising stored on a server or other computer equipment located in this state (other than a server or other computer equipment owned or leased by such person), or (2) having its advertising disseminated or displayed on the Internet by an individual or entity subject to tax under section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six, or article nine-A, twenty-two, thirty-two or thirty-three of this chapter.

> (c) A person, as such term is defined in subdivision (a) of section eleven hundred one of this chapter, *shall not be deemed to be a vendor, for purposes of article twenty-eight of this chapter, solely by reason of (1) having its advertising stored on a server or other computer equipment located in this state (other than a server or other computer equipment owned or leased by such person), or (2) having its advertising disseminated or displayed on the Internet by an individual or entity subject to tax* under section one hundred eighty-three, one hundred eighty-four or one hundred eighty-six, or article nine-A, twenty-two, thirty-two or thirty-three of this chapter.
>
> (d) (i) Except as provided in clause (B) of subparagraph (ii) of paragraph eight of subdivision (b) of section eleven hundred one of this chapter, *a person selling telecommunication services or an Internet access service shall not be deemed to be a vendor, for purposes of article twenty-eight or twenty-nine of this chapter, of tangible personal property or services sold by the purchaser of such telecommunication services or Internet access service solely because such purchaser uses such telecommunication services or Internet access service as a means to sell such tangible personal property or services.*
>
> (ii) For purposes of this subdivision, the term "person" shall refer to any person within the meaning prescribed in either paragraph (c) of subdivision one of section one hundred eighty-six-e of this chapter or subdivision (a) of section eleven hundred one of this chapter, the term "telecommunication services" shall have the meaning prescribed in paragraph (g) of subdivision one of section one hundred eighty-six-e of this chapter, and the term "Internet access service" shall have the meaning prescribed in subdivision (v) of section eleven hundred fifteen of this chapter. (Emphasis added.)

In addition, the provisions of New York Tax Law section 12 enacted in 1998 were not amended when New York enacted its affiliate nexus statute discussed above. Therefore, New York's policy permitting out-of-state retailers to use third-party servers located in New York to make sales to customers in New York and permitting Internet Service Providers to provide specified in-state services to out-of-state retailers without being required to register to collect New York use tax has been codified in a statute since 1998.

Washington's Website Statute

Furthermore, in 2003, the State of Washington added a new statute to its use tax laws to address the use of websites by out-of-state retailers. Paragraphs (5) and (6) of section 82.12.040, title 82 of the Code of Washington, have not been substantially amended since their provisions were enacted in 2003 and currently provide that:

> (5) Notwithstanding subsections (1) through (4) of this section, any person making sales is not obligated to collect the tax imposed by this chapter if:
>
> (a) The person's activities in this state, whether conducted directly or through

another person, are limited to:

(i) The storage, dissemination, or display of advertising;

(ii) The taking of orders; or

(iii) The processing of payments; and

(b) The activities are conducted electronically via a web site on a server or other computer equipment located in Washington that is not owned or operated by the person making sales into this state nor owned or operated by an affiliated person. "Affiliated persons" has the same meaning as provided in RCW 82.04.424.

(6) Subsection (5) of this section expires when: (a) The United States congress grants individual states the authority to impose sales and use tax collection duties on remote sellers; or (b) it is determined by a court of competent jurisdiction, in a judgment not subject to review, that a state can impose sales and use tax collection duties on remote sellers.

Therefore, Washington's policy permitting out-of-state retailers to use third-party servers located in Washington to make sales to customers in Washington without being required to register to collect Washington use tax has been codified in a statute since 2003.

Warranty and Repair Services

Multistate Tax Commission (MTC) Nexus Program Bulletin 95-1 concludes, based upon an analysis of the United States Supreme Court's opinions, that a retailer has a substantial nexus with a taxing state for purposes of imposing a use tax collection obligation if the retailer is providing warranty and repair services in the taxing state through a third-party service provider. Before the MTC issued Bulletin 95-1, the MTC asked the states whether they agreed that the bulletin correctly reflected federal law and each of the individual state's laws and, if so, whether the MTC could include the states' endorsements in the final bulletin, which would subsequently be issued. Based upon the MTC's request, the Board reviewed Bulletin 95-1, and found that it was consistent with California and federal law. Therefore, during its meeting on October 26, 1995, the Board adopted Bulletin 95-1, which was subsequently issued by the MTC in December 1995 with the support of a coalition of 26 states, including California.

However, Mr. Andal distributed a February 13, 1996, memorandum to the Board Members in which he requested that the Board revisit its decision to adopt Bulletin 95-1 because, in his opinion, the bulletin misconstrued federal law and was not consistent with the provisions of section 6203. The Board directed staff to consider and respond to Mr. Andal's comments, and, in March of 1996, the Sales and Use Tax Department presented an issue paper to the Board which provides staff's opinion that Bulletin 95-1 is consistent with both federal and California law, including section 6203. The issue paper also explains that the Board's approval of staff's interpretation of Bulletin 95-1 did not "bind the Board as would a regulation. That is, if a matter

arising under enforcement of staff's interpretation of the proper nexus provisions in this area comes before the Board on a petition for redetermination, the Board will have the opportunity to rule on the matter once again with all of the relevant facts before it."

Thereafter, during its meeting on April 10, 1997, the Board unanimously voted to grant the petition of Airway Scale and Manufacturing Company, Inc., in accordance with Mr. Klehs' opinion that a retailer is not engaged in business in California solely because the retailer uses an in-state independent contractor to perform warranty and repair services on behalf of the retailer. And, during the Board's May 6, 1997, BTC meeting, Mr. Dronenburg made a motion to amend Regulation 1684 to include language he drafted to incorporate the above opinion regarding warranty and repair services and the motion was unopposed. Therefore, staff included Mr. Dronenburg's language with the 1997 amendments to Regulation 1684 regarding websites, Mr. Dronenburg's language was subsequently adopted without changes, and this language still remains part of Regulation 1684, subdivision (a) today.

The Final Statement of Reasons provides the following factual basis for the adoption of the proposed 1997 amendments regarding warranty and repair services:

> [M]any retailers have entered into contracts with instate businesses to perform repair services on such retailers' products purchased by buyers who are residents of this state.
>
> Again, a controversy has arisen as to whether or not these independent contractors are "representatives" of such retailers within the meaning of Section 6203(b) for use tax collection purposes. Upon researching this issue, the Board determined that such repairmen do not qualify under established United States Supreme Court cases as representatives for nexus purposes because they do not participate in the transfer of the property from the out-of-state retailer to the in-state customer but, rather, become involved with the property after (sometimes long after) the sale transaction is concluded. As more and more out-of-state retailers are out-sourcing their warranty responsibilities to instate independent contractors rather than maintaining in-state repair facilities, and no statute addresses this issue, the Board concluded that it was necessary for it to bring certainty to this issue by regulatory action.

As a result, the Board's adoption of the current provisions in Regulation 1684, subdivision (a) regarding warranty and repair services was based upon the Board's 1997 interpretation of United States Supreme Court cases. However, Board staff is not aware of any published California or federal court case decided before or after 1997 that expressly addresses whether a retailer is engaged in business in a taxing state solely because the retailer uses an in-state independent contractor to perform warranty and repair services on behalf of the retailer. We further note that the MTC has not withdrawn Bulletin 95-1.

Recommended Amendments

Board staff currently recommends that Regulation 1684 be amended to (see Exhibit 1):

- Incorporate the new provisions of section 6203 regarding substantial nexus, commonly controlled group nexus, and affiliate nexus;
- Incorporate the physical presence test established in *National Bellas Hess* and affirmed in *Quill* by creating a rebuttable presumption that, unless otherwise provided in Regulation 1684, a retailer is required to collect California use tax if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier or the United States mail or interstate telecommunication;
- Define the terms "advertisement," "soliciting," and "solicitation" for purposes of applying the new affiliate nexus provisions of section 6203 by focusing on the general and broad nature of advertising and the more actively targeted nature of soliciting;
- Explain that the phrases "commission or other consideration" and "commissions or other consideration that is based upon sales of tangible personal property," as used in the new affiliate nexus provisions of section 6203, refer to commissions or other consideration that is based upon completed sales of tangible personal property, similar to the provisions of New York's affiliate nexus statute, as interpreted by TSB-M-08(3)S;
- Create a means by which a retailer can effectively establish that its agreement with a person in California is not the type of agreement that can give rise to affiliate nexus under new section 6203 by utilizing contractual terms and factual certifications that are similar to the contractual terms and factual certifications that a retailer can use to rebut New York's presumption that a retailer has affiliate nexus due to an agreement with a New York resident; and
- Provide that the amendments made to Regulation 1684 to implement the nexus-expanding provisions of AB 155 will become operative when new section 6203 becomes operative on September 15, 2012, or January 1, 2013, and shall not have a retroactive effect.

In addition, until such time, if ever, that the Board were to reverse its prior positions with regard to the proper interpretation and application of federal law, Board staff currently recommends that the Board:

- Retain the current provisions of Regulation 1684 regarding the "taking of orders from customers in this state through a computer telecommunications network" based upon the Board's 1997 interpretation of *Quill*; and
- Retain the current provisions of Regulation 1684 regarding "warranty and repair services" based upon the Board's 1997 interpretation of United States Supreme Court cases.

INITIAL DISCUSSION PAPER

Sales and Use Tax Regulation 1684, *Collection of Use Tax by Retailers*

Summary

Interested parties are welcome to submit comments or suggestions on the issues discussed in this paper, and are invited to participate in the interested parties' meetings scheduled for October 31, 2011 (Sacramento) and November 2, 2011 (Culver City).

Prepared by the Tax Policy Division, Sales and Use Tax Department and Tax & Fee Programs Division, Legal Department

Current as of 10/14/11

1684. Collection of Use Tax by Retailers.

(a) Collection of Use Tax by Retailers Engaged in Business in this State. Retailers engaged in business in this state as defined in Section 6203 of the Revenue and Taxation Code and making sales of tangible personal property, the storage, use, or other consumption of which is subject to the tax must register with the Board and, at the time of making the sales, or, if the storage, use or other consumption of the tangible personal property is not then taxable, at the time it becomes taxable, collect the tax from the purchaser and give the purchaser a receipt therefor.

(b) General Definition and Rebuttable Presumption.

(1) A retailer is engaged in business in this state if the retailer has a substantial nexus with this state for purposes of the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution or federal law otherwise permits this state to impose a use tax collection duty on the retailer. Retailers engaged in business in this state include, but are not limited to, retailers described in subdivision (c).

(2) Except as provided in subdivisions (c) and (d), there is a rebuttal presumption that a retailer is engaged in business in this state as defined in Section 6203 of the Revenue and Taxation Code if the retailer has any physical connection to California besides a connection with customers in California that is exclusively by means of interstate commerce, such as by common carrier, the United States mail, or interstate telecommunication.

(c) Nonexhaustive Examples of Retailers Engaged in Business in this State.

(1) A retailer is engaged in business in this state as defined in Section 6203 of the Revenue and Taxation Code if the retailer:

(A) Owns real or tangible personal property, including, but not limited to, a computer server, in California, leases such property in California, or ~~Any retailer deriving~~ derives rentals from a lease of such ~~tangible personal~~ property ~~situated~~ in California ~~this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.~~;

(B) Maintains, occupies, or uses, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business in California; or

(C) Has a representative, agent, salesperson, canvasser, independent contractor, solicitor, or any other person operating in California on the retailer's behalf, including a person operating in California under the authority of the retailer or its subsidiary, for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property, or otherwise establishing or maintaining a market for the retailer's products.

(2) A retailer is engaged in business in this state as defined in Section 6203 of the Revenue and Taxation Code if:

(A) The retailer is a member of a commonly controlled group, as defined in Revenue and Taxation Code section 25105; and

(B) The retailer is a member of a combined reporting group, as defined in California Code of Regulations, title 18, section 25106.5, subdivision (b)(3), that includes another member of the retailer's commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in California in connection with tangible personal property to be sold by the retailer, including, but not limited to, design and development of tangible personal property sold by the retailer, or the solicitation of sales of tangible personal property on behalf of the retailer.

(3) A retailer is engaged in business in this state as defined in Section 6203 of the Revenue and Taxation Code if the retailer enters into an agreement or agreements under which a person or persons in this state, for a commission or other consideration that is based upon completed sales of tangible personal property, directly or indirectly refer potential purchasers of tangible personal property to the retailer, whether by an Internet-based link or an Internet Web site, or otherwise, provided that: (A) The total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is in excess of ten thousand dollars ($10,000); and (B) The retailer, within the preceding 12 months, has total cumulative sales of tangible personal property to purchasers in California in excess of one million dollars ($1,000,000).

The determination as to whether a retailer has made the requisite amount of sales to purchasers in California during the preceding 12 month period shall be made at the end of each calendar quarter. A retailer is not engaged in business in this state pursuant to this paragraph if the total cumulative sales price of all of the tangible personal property the retailer sold to purchasers in California that were referred to the retailer by a person or persons in California pursuant to an agreement or agreements described above, in the preceding 12 months, is not in excess of ten thousand dollars ($10,000), or if the retailer's total cumulative sales of tangible personal property to purchasers in California were not in excess of one million dollars ($1,000,000) in the preceding 12 months.

For purposes of this paragraph, the term "retailer" includes an entity affiliated with a retailer within the meaning of Internal Revenue Code section 1504, which defines the term "affiliated group" for federal income tax purposes. However, this paragraph does not apply to an agreement under which a retailer purchases advertisements from a person in California, to be delivered on television, radio, in print, on the Internet, or by any other medium, unless (A) the advertisement revenue paid to the person in California consists of commissions or other consideration that is based upon completed sales of tangible personal property, and (B) the person entering into the agreement with the retailer also directly or indirectly solicits potential customers in California through the use of flyers, newsletters, telephone calls,

electronic mail, blogs, microblogs, social networking sites, or other means of direct or indirect solicitation specifically targeted at potential customers in this state.

(4) Paragraph (3) does not apply if the retailer can demonstrate that all of the persons in California with whom the retailer has agreements described in paragraph (3) did not directly or indirectly solicit potential customers for the retailer in California. A retailer can demonstrate that an agreement is not an agreement described in paragraph (3) if:

(A) The retailer's agreement: (i) prohibits persons operating under the agreement from engaging in any solicitation activities in California that refer potential customers to the retailer including, but not limited to distributing flyers, coupons, newsletters and other printed promotional materials, or electronic equivalents, verbal soliciting (e.g., in-person referrals), initiating telephone calls, and sending e-mails; (ii) does not provide for the payment of commissions or other consideration that is based upon sales of tangible personal property to a person or persons operating under the agreement; and, (iii) if the person in California with whom the retailer has an agreement is an organization, such as a club or a non-profit group, the agreement provides that the organization will maintain on its Web site information alerting its members to the prohibition against each of the solicitation activities described above;

(B) The person or persons operating under the agreement in California certify annually under penalty of perjury that they have not engaged in any prohibited solicitation activities in California at any time during the previous year, and, if the person in California with whom the retailer has an agreement is an organization, the annual certification shall also include a statement from the organization certifying that its Web site includes information directed at its members alerting them to the prohibition against the solicitation activities described above; and

(C) The retailer accepts the certification or certifications in good faith and the retailer does not know or have reason to know that the certification or certifications are false or fraudulent.

(5) For purposes of this subdivision:

(A) "Advertisement" means a written, verbal, pictorial, graphic, etc. announcement of goods or services for sale, employing purchased space or time in print or electronic media, which is given to communicate such information to the general public;

(B) "Solicit" means to communicate directly or indirectly to a specific person or specific persons in California in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers; and

(C) "Solicitation" means a direct or indirect communication to a specific person or specific persons done in a manner that is intended to and calculated to incite the person or persons to purchase tangible personal property from a specific retailer or retailers.

(d) Exceptions.

(1) Web Pages and Internet Service Providers. The use of an unrelated third party's computer server on the Internet to create or maintain a World Wide Web page or site by an out-of-state retailer will not be considered a factor in determining whether the retailer has a substantial nexus with California. No Internet Service Provider, On-line Service Provider, internetwork communication service provider, or other Internet access service provider, or World Wide Web hosting services shall be deemed the agent or representative of any out-of-state retailer as a result of the service provider maintaining or taking orders via a web page or site on a computer server that is physically located in this state.

(2) Warranty and Repair Services. A retailer is not "engaged in business in this state" based solely on its use of a representative or independent contractor in this state for purposes of performing warranty or repair services with respect to tangible personal property sold by the retailer, provided that the ultimate ownership of the representative or independent contractor so used and the retailer is not substantially similar. For purposes of this paragraph, "ultimate owner" means a stock holder, bond holder, partner, or other person holding an ownership interest.

(~~b~~3) Convention and Trade Show Activities. For purposes of this subdivision, the term "convention and trade show activity" means any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Except as provided in this paragraph, a retailer is not "engaged in business in this state" based solely on the retailer's convention and trade show activities provided that:

(~~1~~A) For the period commencing on January 1, 1998 and ending on December 31, 2000, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than seven days, in whole or in part, in this state during any 12-month period and did not derive more than ten thousand dollars ($10,000) of gross income from those activities in this state during the prior calendar year;

(~~2~~B) For the period commencing on January 1, 2001, the retailer, including any of his or her representatives, agents, salespersons, canvassers, independent contractors, or solicitors, does not engage in those convention and trade show activities for more than fifteen days, in whole or in part, in this state during any 12-month period and did not derive more than one hundred thousand dollars ($100,000) of net income from those activities in this state during the prior calendar year.

A retailer coming within the provisions of this subdivision is, however, "engaged in business in this state," and is liable for collection of the applicable use tax, with respect to any sale of tangible personal property occurring at the retailer's convention and trade show activities and with respect to any sale of tangible personal property made pursuant to an order taken at or during those convention and trade show activities.

(~~c~~e) Retailers Not Engaged in Business in State. Retailers who are not engaged in business in this state may apply for a Certificate of Registration-Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the Board in the same manner as retailers engaged in business in this state. As used in this regulation, the term "Certificate of Registration-Use Tax" shall include Certificates of Authority to Collect Use Tax issued prior to September 11, 1957.

(~~d~~f) Use Tax Direct Payment Permit Exemption Certificates. Notwithstanding subdivisions (a) and (~~b~~d)(3), a retailer who takes a use tax direct payment exemption certificate in good faith from a person holding a use tax direct payment permit is relieved from the duty of collecting use tax from the issuer on the sale for which the certificate is issued. Such certificate must comply with the requirements of Regulation 1699.6, Use Tax Direct Payment Permits.

(~~e~~g) Tax as Debt. The tax required to be collected by the retailer and any amount unreturned to the customer which is not tax but was collected from the customer under the representation that it was tax constitute debts owed by the retailer to the state.

(~~f~~h) Refunds of Excess Collections. Whenever the Board ascertains that a retailer has collected use tax from a customer in excess of the amount required to be collected or has collected from a customer an amount which was not tax but was represented by the retailer to the customer as being use tax, no refund of such amount shall be made to the retailer even though the retailer has paid the amounts so collected to the state. Section 6901 of the Revenue and Taxation Code requires that any overpayment of use tax be credited or refunded only to the purchaser who made the overpayment.

(i) Amendments. Statutes 2011, chapter 313 (Assem. Bill No.155), section 3 re-enacted Section 6203 of the Revenue and Taxation Code. Chapter 313, section 6, provides that the provisions of Section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on September 15, 2012, or January 1, 2013. The 2012 amendments to this regulation adopted to implement, interpret, and make specific the provisions of Section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3, shall become operative on the same date as Section 6203 of the Revenue and Taxation Code as re-enacted by chapter 313, section 3. Any amendment that implements, interprets and makes specific a use tax collection obligation that did not exist on June 27, 2011, upon becoming operative, shall not have any retroactive effect.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 6203, 6204, 6226 and 7051.3, Revenue and Taxation Code; and Section 513(d)(3)(A), Internal Revenue Code (26 USC).